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SUBJECT: KAZAKHSTAN: GOVERNMENT ADDRESSING CHALLENGES IN BANKING,  
CONSTRUCTION; SEES MODERATED GROWTH IN 2008

Ref: Astana 3025

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11. (SBU) Summary. Kazakhstan's central bank foresees 7 percent economic growth in 2008. Even so, the bank's chairman acknowledged to the Ambassador that challenges remain, particularly for the banking and construction sectors. The government appears firm in its commitment to support Kazakhstani banks, as necessary, and is already propping up the construction sector with budgetary funds. Still, the construction sector appears to be heading for difficult times. Nevertheless, the tenge remains stable, the outflow of foreign reserves has ebbed, and the National Oil Fund is growing briskly. End summary.

A Soft Landing?  
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12. (SBU) Anvar Saidenov, Chairman of the National Bank of Kazakhstan (NBK, the country's central bank), told the Ambassador on November 9 that the aftereffects of the current global financial turbulence on the Kazakhstani economy (reftel) are well under control. According to Saidenov, Kazakhstani commercial banks are servicing their debts on schedule. As the banks are slowly unwinding their large external debts, <sup>Qc4Qs</sup> 10.7 percent in 2006 and 9.7 percent in the first nine months of 2007. End note.) Saidenov added that the current inflationary pressures are mostly due not to domestic liquidity ("which is high but not growing"), but to global trends, such as rising food and commodity prices. Still, he stated that with December-to-December inflation expected to reach 15 percent, the NBK will probably have to raise interest rates.

13. (SBU) After a prolonged period of building up foreign reserves in an effort to slow down the tenge's appreciation, the NBK had to sharply reverse course in August in order to keep the domestic currency from falling (reftel). With Kazakhstani banks no longer able to borrow abroad and instead servicing their accumulated external debts, their growing demand for foreign currency is pressuring the tenge. By intervening via open market operations to keep the tenge at or around 121 to the dollar, the NBK has been providing implicit support of sorts to Kazakhstani banks (which have deposits in tenge but debts in foreign currency). As a result, the NBK's foreign reserves fell from \$22.0 billion in August to \$17.4 billion at the end of October. In a possible sign that market pressures on the tenge are receding somewhat, the NBK's reserves recovered by November 15 to \$18.2 billion. Saidenov told the Ambassador that the NBK does not want to lose "too much in reserves" in defending the tenge and, therefore, expects it to depreciate somewhat.

14. (SBU) Saidenov noted that the National (Oil) Fund (NF) continues

to grow "very fast," already exceeding \$20 billion in assets, and "is not being touched for now." He elaborated that only a KZT 340 billion (\$2.8 billion) "guaranteed transfer" from the NF to the budget is currently planned for 2008. Increasing the guaranteed transfer or sending more petrodollars into the budget (instead of the NF) would, Saidenov noted, require an act of Parliament.

#### But Real Estate and Construction Catch a Cold

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15. (SBU) Kazakhstani banks, Saidenov continued, remain vulnerable to a collapse in the domestic real estate sector. However, he expects a cooling, not a collapse. He stressed that the government will support the real estate sector due to "social factors," referring to the government's recently announced \$4 billion support package. The sum is to be disbursed over several years, and is earmarked specifically for the banking and construction sectors, which are seen as most affected by the current turbulence. Approximately \$1 billion has already been disbursed under the plan. The money, explained Saidenov, has been given to the Kazyna Sustainable Development Fund, which will lend it, at reduced interest rates, to commercial banks. Under the terms of the program, the banks will be obligated to loan the funds to the construction sector at favorable interest rates. Still, Saidenov acknowledged the challenges facing the banking sector ("next year will be tough for banks") and the construction sector ("some cleansing and consolidation will have to happen").

16. (SBU) Very difficult times on the construction sector's horizon was the picture painted on November 9 for the Ambassador by Dennis Price, an Almaty-based American executive with Kuat, a leading Kazakhstani residential construction firm. According to Price, the Kazakhstani construction industry's two leaders, Kuat and Basis A, are both in dire straits. According to Price, the two will not

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merge, but only one will survive. He said that Kuat's sales have virtually come to a standstill over the past six months, and the company has not been paying wages since mid-August. (Note: On November 1, about 100 Kuat construction workers held a largely unprecedented rally in Astana in front of President Nazarbayev's palace, protesting unpaid wages. End note.) Price described Kuat as a company plagued by a lack of transparency and bad management. While Kuat's cost structure is very vague, Price estimated the company's construction cost at \$2,000 per square meter, a figure he described as excessively high, partly due to managerial "skimming." By contrast, Price said, the government is only willing to bail out banks and construction companies at \$1,000 per square meter. He added that he expects the Almaty real estate prices to settle down in the \$1,500-1,800 per square meter range in the next four years.

17. (SBU) While government support may be key to helping the real estate and construction sectors weather the current storm, its actual effects may, at least in the short term, be more complex. Galym Orazbakov was quoted by the media in October, stating that the government would buy housing from "weak" builders and sell it to the public at just \$800 per square meter. According to one informed observer, the well-intentioned announcement had a chilling effect on the real estate market, as the already nervous public settled in to wait for prices to fall to \$800.

#### Comment

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18. (SBU) The latest projection of 7 percent economic growth in 2008 provides a telling indicator of the Kazakhstani economy's oil-fueled resilience. While the unwinding of Kazakhstani banks' commercial debt may lead to medium-term tenge depreciation and some depletion of foreign reserves in support of the currency, the long-term trend for the tenge will be dictated by the country's growing oil exports and thus remains toward appreciation. The government stands ready to support the banks and, to some extent, the construction sector. In the case of the banks, this is designed to provide liquidity and credit to the non-extractive sectors that might otherwise be in serious trouble if credit lines dried up. In the case of housing, the government is motivated in part to "rescue" individual

purchasers who have made very substantial pre-payments when or before construction started. It is unclear, however, how effective government action will be in supporting the unraveling real estate bubbles in Almaty and Astana. There is also some risk that government action will go too far, rewarding reckless lending with a bailout and creating a moral hazard. Prime Minister Masimov told the Ambassador that the government is looking into purchasing existing mortgages from lenders, thus creating a secondary market. Such a step would inject liquidity into the economy, help compensate for the weak deposit base of the domestic banks, and avoid having the government or its institutions direct lending to specific sectors.

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